

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE TOKOLOGO LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Tokologo Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, the statement of comparison of budget and actual amounts, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment, as all assets could not be verified and assets were identified that were not

included on the asset register. I was unable to confirm property, plant and equipment by alternative means. In addition, assets were included that did not meet the definition of an asset as outlined in the requirements of GRAP 17, *Property, plant and equipment*. The municipality also did not correctly account for impairment assessment of all of the municipality's assets at each reporting date in accordance with GRAP 17 and GRAP 26, *Impairment of cash-generated assets*. I was not able to determine the correct net carrying amount of property, plant and equipment as it was impracticable to do so. Consequently, I was unable to determine whether any further adjustment relating to property, plant and equipment stated at R465 683 726 (2012: R415 489 531) in note 10 to the financial statements was necessary.

Investment property

7. I was unable to obtain sufficient appropriate audit evidence regarding investment property stated at R30 911 400 in note 9 in the financial statements due to reconciliations not being performed between the municipal properties per the valuation roll and properties per the municipality's asset register and a lack of title deeds for municipal properties. I was unable to confirm investment property by alternative means. Consequently, I was unable to determine whether any further adjustments to the amount disclosed for investment property were necessary.

Cash flow statement

8. I was unable to obtain sufficient appropriate audit evidence regarding the cash flow statement due to the limitations placed on my audit of various components of the financial statements. I was unable to confirm the cash flow statement by alternative means. Consequently, I was unable to determine whether any adjustments relating to the cash flow statement in the financial statements were necessary.

Accumulated surplus

9. The municipality did not have adequate internal control systems in place to ensure that transactions were accurately accounted for. I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed and could not confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments to accumulated surplus stated at R499 172 209 (2012:R432 170 428) and the resultant disclosure in the statement of changes in net assets in the financial statements were necessary.

Aggregation/accumulation of immaterial uncorrected misstatements

10. The financial statements as a whole were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, the statement of financial performance and the notes to the financial statements:
 - Contracted services reflected as R3 333 886 were overstated by R522 173.
 - Receivables from exchange transactions reflected as R1 535 125 were overstated by R458 372.
 - General expenditure reflected as R9 814 901 was understated by R608 675.
 - Grants and subsidies paid reflected as R254 451 were understated by R877 014.
 - Irregular expenditure reflected as R47 582 909 was understated by R 626 049.

11. In addition, I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm the following elements by alternative means:

- Finance lease obligation reflected as R677 929 in the previous year.
- Property rates of R308 281 as included in the disclosed amount of R2 343 116 in the previous year.
- Employee-related cost of R224 173 as included in the disclosed amount of R20 394 491.

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Opinion

12. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Tokologo Local Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Restatement of corresponding figures

14. As disclosed in note 39 to the financial statements, the corresponding figures for 2012 were restated as a result of an error discovered during 2013 in the financial statements of the Tokologo Local Municipality at, and for the year ended, 30 June 2012.

Irregular expenditure

15. The full extent of the irregular expenditure of R47 582 909, as disclosed in note 45 to the financial statements, was still in the process of being investigated.

Material losses/impairments

16. As disclosed in note 6 to the financial statements, a provision for a decrease in value to the amount of R37 173 684 (96%) (2012: R32 146 770) (95%) was made with regard to amounts owing to the municipality in respect of services rendered by the municipality, rates and taxes and other charges amounting to R38 708 809 (2011: R33 719 742).

Additional matters

17. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material inconsistencies in other information included in the annexures

18. Appendix B to the financial statements indicates that the carrying value of property, plant and equipment amounted to R463 844 782. This was inconsistent to the amount of R 465 683 726 disclosed in note 10 to the financial statements.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

19. In accordance with the PAA and the general notice issued in terms thereof, I report the

following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

20. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
21. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

The reliability of the information in respect of the selected development objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

22. The material findings are as follows:

Usefulness of information

Presentation

23. Section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 24% of the planned targets that were not achieved were not reflected in the annual performance report. This was due to the lack of oversight by management.

Measurability

24. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 21% (>20%) of the targets and/or significantly important targets in relation to the overall mandate of the entity. This was due to the lack of monitoring and reviewing by management.
25. The FMPPI requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. All of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management did not implement the requirements of the FMPPI.

Reliability of information

26. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. The information presented with respect to municipal financial viability and management was not reliable when compared to the source information and evidence provided. This was due to the lack of frequent review of validity of reported achievements against source documentation and the officials' lack of understanding of proper record keeping and reporting on service delivery.
27. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to the service delivery and infrastructure development. This was due to the lack of frequent review of validity of reported achievements against source documentation and the officials' lack of understanding of proper record keeping and reporting on service delivery.

Compliance with laws and regulations

28. I performed procedures to obtain evidence that the entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

29. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan was submitted to the council for adoption, as required by regulation 15(3) of the Municipal Planning and Performance Management Regulation (MPPMR).
30. The performance management system of the municipality was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan and did not relate to the municipality's performance management processes and/or did not provide for procedures whereby the system was linked to the municipality's integrated development planning processes, as required by section 38(a) of the MSA.
31. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
32. The municipality did not set key performance indicators, including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the integrated development plan, as required by section 41(1)(a) of the MSA and MPPMR 1 and 9(1)(a).
33. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls, as required by section 62(1)(c)(i) of the MFMA.

34. The accounting officer of the municipality did not, by 25 January, assess the performance of the municipality during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.

Budgets

35. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.
36. Quarterly reports on the implementation of the budget and financial state of affairs of the municipality were not submitted to the council within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
37. Monthly budget statements were not submitted to the mayor or provincial treasury, as required by section 71(1) of the MFMA.

Annual financial statements, performance and annual reports

38. The financial statements submitted for auditing were not prepared, in all material respects, in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current and current assets, and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records were provided, but supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
39. The 2011-12 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
40. The Oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2011-12 annual report was tabled, as required by section 129(1) of the MFMA.
41. The annual report for the year under review was not submitted to the audit team.
42. The annual performance report for the year under review did not include the performance of each external service provider, as required by section 46 (1)(a),(b),(c) of the MSA.

Audit committees

43. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management, performance evaluation, as required by section 166(2)(a) of the MFMA.
44. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
45. The audit committee did not advise the council/accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
46. The audit committee did not respond to the council on the issues raised in the audit reports of the auditor-general, as required by section 166(2)(c) of the MFMA.
47. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.
48. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by MPPMR 14(4)(a)(i).

49. The audit committee did not review the municipality's performance management system and/or make recommendations to the council, as required by MPPMR 14(4)(a)(ii).
50. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by MPPMR 14(4)(a)(iii).

Internal audit unit

51. The internal audit unit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and MPPMR 14(1)(a).
52. The internal audit unit did not audit the performance measurements on a continuous basis and/or submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by MPPMR 14(1)(c).
53. The internal audit unit did not function as required by section 165(2) of the MFMA, in that it did not advise the accounting officer and/or report to the audit committee on matters relating to internal controls, accounting procedures and practices, risk and risk management and loss control.
54. The internal audit unit did not advise the accounting officer and/or report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Procurement and contract management

55. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by regulation 17(a) and (c) of the Supply Chain Management (SCM) Regulations.
56. Quotations were accepted from prospective providers who were not registered as accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
57. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
58. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e) or the code of conduct for councillors issued in terms of the MSA or the code of conduct for staff members issued in terms of the MSA.
59. A list of accredited prospective providers was not in place for procuring goods and services through quotations, as required by SCM regulation 14(1)(a).
60. Sufficient appropriate audit evidence could not be obtained that all contracts and/or quotations were awarded and accepted in accordance with the legislative requirements and a procurement process which was fair, equitable, transparent and competitive.

Human resource management and compensation

61. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by regulation 14(2)(a) of the Regulations on Minimum Competency Levels.

62. The competencies of financial and SCM officials were not assessed in a timely manner in order to identify and address gaps in competency levels, as required by regulation 13 of the Municipal Regulations on Minimum Competency Levels.
63. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff, in contravention of section 67(d) of the MSA.

Expenditure management

64. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
65. Payments were made without the approval of the accounting officer or a properly authorised official, as required by section 11(1) of the MFMA.
66. An effective system of expenditure control, including procedures for the approval/authorisation, was not in place, as required by section 65(2)(a) of the MFMA.
67. Reasonable steps were not taken to prevent unauthorised, irregular expenditure as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants

68. The municipality did not submit quarterly performance reports to the transferring national officer, the provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.
69. Unspent conditional grant funds not committed to identifiable projects and not approved by the National Treasury for retention were not surrendered to the National Revenue Fund, as required by section 21(1) of DoRA.

Revenue management

70. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
71. A tariff policy was not implemented for the levying of fees for provision of municipal services, as required by section 74(1) of the MSA and section 62(1)(f)(i) of the MFMA.
72. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.
73. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
74. An effective system of internal control for debts was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

75. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

76. An adequate management, accounting and information system which accounted for liabilities was not in place, as required by section 63(2)(a) of the MFMA.

77. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.
78. Long-term debt was incurred without a resolution of the municipal council approving the debt agreement, in contravention of section 46(2) of the MFMA.

Consequences management

79. Unauthorised expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
80. Irregular expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
81. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
82. Irregular and fruitless and wasteful expenditure was not adequately investigated and therefore could not be recovered from the liable person, as required by section 32(2) of the MFMA.
83. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.

Internal control

84. I considered internal control relevant to my audit of the financial statements annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

85. Key management positions were vacant during the year under review and a lack of capacity in the finance and procurement sections, resulted in non-compliance with applicable legislation and gave rise to unauthorised, irregular as well as fruitless and wasteful expenditure.
86. Furthermore, the lack of decisive action to implement timely corrective measures and address non-performance was evidenced by the failure of management to adequately address external audit findings in a timely manner. This resulted in the audit findings in the previous year report recurring in the current year.

Financial and performance management

87. Effective performance systems, processes and procedures as well as the management thereof had not been adequately developed and implemented. As a result, significant difficulties were experienced in respect of the availability of adequate information, especially with regard to reporting on service delivery issues due to a lack of competencies.
88. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in many findings relating to incorrect disclosure or

non-disclosure. The municipality did not have the capacity to address backlog issues and financial system problems, resulting in the need to appoint consultants. Consultants assisted with the preparation of an asset register and financial statements. Finance staff had an insufficient understanding of the accounting framework. This contributed to the numerous adjustments made in the financial statements of the municipality.

Governance

89. Internal control deficiencies were not identified, communicated and corrected in a timely manner. The implementation of external audit recommendations was not prioritised and also not monitored. This resulted in the previous year audit findings not being substantially addressed.
90. Although the municipality had an internal audit division, it was not adequately resourced and functioning. An audit committee and performance audit committee were also not in place for the entire financial year under review.

Auditor General
Bloemfontein

18 December 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence